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Message Text

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ACTION EUR-12

INFO OCT-01 EA-10 IO-13 ISO-00 CIAE-00 DODE-00 NSAE-00
NSCE-00 SSO-00 ICAE-00 INRE-00 SP-02 AID-05 EB-08
SS-15 STR-07 OMB-01 CEA-01 FRB-03 INR-10 XMB-02
OPIC-03 LAB-04 SIL-01 AGRE-00 DOE-15 SOE-02 /115 W
----------025371 051134Z /11
O R 051118Z MAY 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC IMMEDIATE 5835
TREASURY DEPT WASHDC IMMEDIATE
INFO AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
USMISSION GENEVA
USDOC WASHDC
AMCONSUL BELFAST
AMCONSUL EDINBURGH

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USEEC ALSO FOR EMBASSY
USOECD ALSO FOR EMBASSY
USMTN

E.O. 11652: N/A
TAGS: PINT, PGOV, EFIN, UK
SUBJECT: OUTLOOK FOR KEY VOTE ON FINANCE BILL

REF: LONDON 5353

SUMMARY: MAY 8 WILL BE THE CRITICAL DAY FOR THE GOVERNMENT'S FINANCE BILL. AT THIS POINT GOVERNMENT DOES NOT HAVE THE VOTES TO BLOCK AMENDMENTS WHICH WOULD
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LOWER TAX RATES ON HIGHER INCOMES AND THE STANDARD RATE BY ONE PERCENT -- ESTIMATED COST 500 MILLION POUNDS -- BUT NEITHER DOES THE OPPOSITION HAVE THE VOTES TO ASSURE THEIR APPROVAL. THE OUTCOME WILL THEREFORE HINGE ON THE ACTIONS OF A HANDFUL OF ULSTER UNIONIST MPS. OUR LABOR PARTY SOURCES DO NOT BELIEVE CALLAGHAN WILL CALL AN ELECTION IF THESE AMENDMENTS ARE APPROVED,

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AS THEIR AGGREGATE COST WILL BE WITHIN A TOLERABLE RANGE, AND THEY CITE BRITAIN'S CURRENT RESERVE POSITION AS SUFFICIENT TO PERMIT A STRONG DEFENSE OF STERLING, SHOULD FOREIGN EXCHANGE MARKETS REACT NEGATIVELY TO THE PROBABILITY OF AN INCREASED PUBLIC SECTOR BORROWING REQUIREMENT (PSBR). SOME LABOR MPS, HOWEVER, WILL URGE CALLAGHAN TO ALLOW THE POUND TO SLIDE AND GO TO THE POLLS. END SUMMARY.

1. THE GOVERNMENT'S FINANCE BILL WILL BEGIN ITS COMMITTEE STAGES MAY 8 WITH COMMONS SITTING AS A COMMITTEE OF THE WHOLE, AND THE CRITICAL VOTES ON MAJOR AMENDMENTS TO THE BILL ARE EXPECTED TO OCCUR THAT EVENING. THE CONSERVATIVES APPEAR SET TO INTRODUCE TWO MAJOR AMENDMENTS, ONE CUTTING THE MARGINAL TAX RATES FOR HIGH INCOME LEVELS AND ANOTHER CUTTING THE STANDARD TAX RATE BY ONE PERCENT. THE ESTIMATED COST OF THESE AMENDMENTS IS ABOUT 500 MILLION POUNDS. THE LIBERALS ARE ALSO EXPECTED TO INTRODUCE AN AMENDMENT PROPOSING A TWO-PERCENT CUT IN THE STANDARD RATE. AT THIS POINT THE GOVERNMENT DOES NOT APPEAR TO HAVE THE VOTES NEEDED TO BLOCK APPROVAL OF THE ANTICIPATED TORY AMENDMENTS, THOUGH THE LIBERAL PROPOSAL IS GIVEN NO CHANCE OF PASSAGE, BECAUSE IT WILL NOT RECEIVE CONSERVATIVE FRONT-BENCH ENDORSEMENT.

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2. ACCORDING TO GOVERNMENT WHIPS, THE TORIES ARE ASSURED OF THE SUPPORT OF THE LIBERALS, SCOTTISH NATIONALISTS, WELSH NATIONALISTS AND THREE ULSTER UNIONISTS. IF ALL OF THESE MPS ARE PRESENT AND VOTING, THE OPPOSITION WOULD MUSTER 311 VOTES, PRECISELY THE MAXIMUM NUMBER THE GOVERNMENT BELIEVES IT CAN TURN OUT. AT THE MOMENT, SEVEN ULSTER UNIONIST MPS ARE NOT COMMITTED. WHILE GOVERNMENT SOURCES DENY THEY HAVE STRUCK A DEAL WITH THE UNIONISTS -- INDEED, THEY ARGUE THAT THERE IS NOTHING THEY CAN TRADE FOR UNIONIST SUPPORT -- THEY ACKNOWLEDGE THAT GOVERNMENT MINISTERS HAVE MET INFORMALLY WITH UNIONIST LEADER JAMES MOLYNEAUX AND ENOCH POWELL. THE LATTER IS A STRICT MONETARIST AND CAN THEREFORE BE ASSUMED TO BE UNSYMPATHETIC TO ANY MOVE THAT WOULD INCREASE THE PSBR AND, MOREOVER, IS GENERALLY UNWILLING TO DO MRS. THATCHER ANY FAVORS. THUS, THE OUTCOME OF THE KEY VOTES WILL PROBABLY HINGE ON (A) THE NUMBER OF UNIONISTS WHO ATTEND PARLIAMENT MAY 8, AND (B) HOW THOSE WHO DO ATTEND WILL VOTE.

3. FACED WITH THIS SITUATION, THE GOVERNMENT HAS TOLD ITS BACKBENCHERS THAT IT EXPECTS TO LOSE ON BOTH

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CONSERVATIVE AMENDMENTS. PRIVATELY, HOWEVER, SOME CABINET MEMBERS AND MINISTERS HAVE NOT GIVEN UP HOPE. LABOR BACKBENCHERS TOO ARE HOPEFUL THE GOVERNMENT CAN WIN, BUT REPORT THAT TREASURY MINISTERS HAVE BEEN

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QUIETLY PASSING THE WORD THAT THE GOVERNMENT IS CURRENTLY PREPARED TO LIVE WITH A 500 MILLION ADDITIONAL TAX-CUT PACKAGE. USUALLY WELL INFORMED BACKBENCHERS HAVE SUGGESTED THAT SINCE THERE HAS BEEN A TENDENCY FOR TREASURY TO OVERESTIMATE THE PSBR, THIS MAY WELL AGAIN BE THE CASE. IN ADDITION, THESE SOURCES CONSIDER THAT BRITAIN'S CURRENT RESERVE POSITION, DESPITE LAST MONTH'S THREE BILLION DOLLAR FALL, WILL ALLOW THE BANK OF ENGLAND TO MOUNT A STRONG DEFENSE OF THE POUND, SHOULD FOREIGN EXCHANGE MARKETS BEGIN HEAVY SELLING IN RESPONSE

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TO FURTHER TAX CUTS. ACCORDINGLY, THERE IS A CONSENSUS
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IN THE PARLIAMENTARY LABOR PARTY THAT CALLAGHAN PROBABLY WILL NOT CALL AN ELECTION IF THE TORY AMENDMENTS ARE PASSED. BUT THEY ARE QUICK TO POINT OUT THAT THE ULTIMATE DECISION WILL BE CALLAGHAN'S ALONE, THOUGH HE IS EXPECTED TO TAKE COUNSEL FROM VARIOUS FACTIONS IN THE PARTY. SOME LEFT-WINGERS WOULD PREFER TO SEE THE GOVERNMENT LET THE POUND SLIP A BIT AND THEN HAVE CALLAGHAN CALL AN ELECTION TO BE FOUGHT ON THE ISSUE OF TORY FINANCIAL IRRESPONSIBILITY. THIS, THEY ARGUE, WOULD ALLOW LABOR TO WIN A CLEAR OVERALL MAJORITY IN COMMONS.

4. COMMENT: FROM WHERE WE SIT, THE OUTCOME OF THE CRITICAL MAY 8 VOTES IS SIMPLY TOO CLOSE TO PREDICT, THOUGH WE SUSPECT POWELL WILL AGAIN DELIVER FOR THE GOVERNMENT. BUT EVEN IF THE GOVERNMENT SHOULD LOSE, IT APPEARS UNLIKELY CALLAGHAN WOULD OPT TO CALL A GENERAL ELECTION. SINCE THE LIKELIHOOD OF FURTHER TAX CUTS BECAME APPARENT, FOREIGN EXCHANGE MARKETS HAVE BEEN NERVOUS. SOME OBSERVERS CONSIDER THAT THE GOVERNMENT DID NOT OBJECT TO THE RISE IN MAXIMUM LENDING RATE, EXPECTED TODAY, IN PART BECAUSE THIS WOULD REDUCE THE LIKELIHOOD OF A SERIOUS RUN ON STERLING, SHOULD THE TORY AMENDMENTS BE ADOPTED.

BREWSTER

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FINANCE, VOTING, LEGISLATIVE BILLS, TAXES
Control Number: n/a
Copy: SINGLE
Draft Date: 05 may 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978LONDON07111
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D780192-0162
Format: TEL
From: LONDON USEEC
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780589/aaaacydx.tel
Line Count: 203
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 4ec9cba3-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 78 LONDON 5353
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 05 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: N/A
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2779740
Secure: OPEN
Status: NATIVE
Subject: OUTLOOK FOR KEY VOTE ON FINANCE BILL
TAGS: PINT, PGOV, EFIN, UK
To: STATE TRSY
Type: TE
vdkvgwkey: odbc://SAS/SAS.dbo.SAS_Docs/4ec9cba3-c288-dd11-92da-001cc4696bcc
Review Markings:
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Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014